Comments Received

August 15-31, 2005

Mason, Monte

From: John Lee [jlee@crowleylaw.com]

Sent: Monday, August 15, 2005 10:30 AM

To: Mason, Monte

Cc: Colby Branch

Subject: FW: Comment Regarding DNRC Proposal for Higher State Royalty

Monte: I concur with Colby's comments. I would recommend leaving royalties as they presently exist, and if appropriate utilize the authority already provided the DNRC to require higher royalty leases where indicated on a case-by-case basis. Alternatively, North Dakota, in my estimation, has the most appropriate and balanced approach. Regards, John

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From: Colby Branch

Sent: Monday, August 15, 2005 10:02 AM

To: John Lee

Subject: FW: Comment Regarding DNRC Proposal for Higher State Royalty

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From: Colby Branch

Sent: Monday, August 15, 2005 10:01 AM

To: 'mmason@mt.gov'

Subject: Comment Regarding DNRC Proposal for Higher State Royalty

Dear Monty:

Thank you for the opportunity to comment on the Department's proposal to increase the state's royalty on oil and gas leases. I respectfully offer the following brief comments:

1. The proposal assumes that raising the lease royalty will result in higher revenues to the State, but there is a complete absence of any supporting economic analysis. The following negative economic consequences of the proposal should be considered:

a. The higher royalty will discourage exploration on state lands, resulting in fewer discoveries and associated royalties.

b. Many state leases are never drilled, and many of those that are turn out to be barren. By discouraging the leasing of state lands, at least part of the

higher royalty will be offset by fewer sales (and resulting bonuses and rentals).

c. Any bid at a state sale is based on the anticipated economics of the particular play. All other factors being equal, the higher royalty will result in lower

bonuses across the board.

d. The higher royalty will lower the economic threshold for producing wells, resulting in premature abandonment and lower royalties.

2. The analysis of current fee mineral royalties does not comport with my experience. I examine title in Montana, Wyoming and North Dakota, and continue to see many 12.5% leases, especially in wildcat areas.

3. The analysis of overriding royalty misses the point. Many (most?) wildcat plays in Montana are put together by independent brokers, whose primary consideration is the retention of an overriding royalty when selling the play. There is a limit, however, to the overall burden that buyers are willing to assume. By raising the state's royalty, you've taken much or all of the broker's profit, thereby effectively dampening exploration and leasing. Also, overriding royalties are commonly retained in the sale of a producing property, often as a means of allocating risk between the parties in an uncertain market. The retained royalty, of course, is reflected in a lower sale price. A royalty retained in the sale of a producing property has no relationship nor bearing, and should not be compared, to leasehold royalty.

4. An increase in state royalty would be "inflationary," in that it would drive the royalty for fee leases upwards as well. Thereby diminishing activity across the board.

Colby Branch
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Mason, Monte

From: Betsy Campen [Betsycampen@bresnan.net]

Sent: Sunday, August 14, 2005 11:11 AM

To: Mason, Monte

Subject: state royalty rates

Dear Monte:

We are very much against raising the royalty rate on state school trust lands. We have enough trouble getting people to drill in Montana now because of taxes and environmental issues. Raising the royalty rate is just going to be one more deterrent. We should be thinking of ways to encourage people to explore for natural resources, not making it more difficult. Ted and I encourage the land board to look at the issue from this perspective. 12.5% of something is better than 16.67% of nothing.

Betsy Campen
Certified petroleum geologist

Cordillera
ENERGY PARTNERS

RECEIVED
AUG 1 7 2005
D.N.R.C.

August 15, 2005

Monte Mason
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

RE: Proposed royalty increase on School Trust Lands

Dear Mr. Mason:

It is with a great deal of concern that I read of the DNRC considering increasing the royalty rates on oil and gas leases on all School Trust Lands. The purpose of my letter is to set out in detail the negative repercussions this action could have to the oil and gas industry and to the revenue stream to the State School fund.

As you are aware, prior to 1999 Montana had the dubious distinction of having the highest and most complicated oil and gas tax rates in the Rocky Mountains. Consequently, exploration activity in Montana languished to the point that, for a time, no drilling rigs were working within the State. Production and tax revenues were plummeting and the industry was all but extinguished. Fortunately, a bipartisan group of concerned legislators crafted in the 1999 legislature the monumental legislation known as the "tax competitiveness and simplification act." This act lowered taxes to compete with the surrounding States and simplified the tax structure regarding production taxes. Working with the Department of Revenue, this legislation was enacted and signed by the Governor. Almost immediately, exploration activity increased, and Montana is now one of the few states in the nation with increasing production revenues and increasing oil and gas volumes. This work was done in partnership with the State and the oil and gas industry as exemplified by the enclosed brochure. What a tremendous benefit this has been to all parties, including the approximately 1500 newly hired Montana workers!

The oil and gas industry has always been extremely competitive. Risk and capital costs can be staggering. Different States and Federal entities have competed for the tax revenues and heavy capital investments needed in the oil and gas industry. As an example, the Department of Interior, Bureau of Land Management oil and gas leases are set at a flat one-eighth (1/8) royalty. Additionally, the royalty rates in Colorado and Utah for State lands is also set at one-eighth (1/8). In North Dakota, State lands are leased at a one-eighth royalty rate for all lands within the State with the exception of lands within one mile of existing production, which are leased at a one-sixth (1/6) royalty. A large amount of the revenue derived by leasing these lands is obtained by the first year

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competitive bonus. By making the royalty rate attractive, competition is intense and lease bonuses remain in the millions of dollars a year.

Montana has numerous unproductive, but prospective, geologic basins which are in dire need of exploration and investment. (Judith Basin, Wheatland Basin, Crazy Mountain Basin, Bull Mountain Basin, to name a few). The last thing that the State of Montana should do is to set a prohibitively high royalty rate on School Trust Lands in these areas.

It is understandable that the DNRC wishes to receive its "fair share" of the pie during these times of high energy prices. However, sustained and predictable revenue should be the first priority. Boom and bust times have been a historic trend within the State to the detriment of many. By maintaining a competitive and predictable tax and royalty structure, we can help lessen the bumps along the way for years to come. Revenues and employment within the oil and gas industry could remain vibrant for the benefit of our citizens, schools and communities. I ask that you leave the royalty rates as they are for the benefit of all Montanans.

Yours very truly,

Cordillera Energy Partners II, LLC

James E. Powers
Vice President, Business Development

JEP:sld

cc: Brian Schweitzer, Governor
Linda McCulloch, Superintendent of Public Instruction
Brad Johnson, Secretary of State
Mike McGrath, Attorney General
John Morrison, State Auditor
John Bohlinger, Lt. Governor

EnSource Corporation

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August 14, 2005

State Board of Land Commissioners
Department of Natural Resources and Conservation
Trust Land Management Division
P.O. Box 201601
Helena, MT 59260-1601

Re: Royalty Rate Review
State of Montana Oil and Gas Leases
Proposal to increase the royalty on State Trust Lands Oil and Gas leases to 1/6th

Members of the Board,

I have worked in the petroleum industry as an attorney and landman for more than 25 years. I lived in Montana and my children attended school there. After reviewing the report of Mr. Monte Mason ("the Report") I offer the following comments.

The most important, and I believe unanswered, questions revealed by the Report are:

- Will the proposed royalty increase result in increased revenues to the State?
- Is an increase in royalty on State lands a disincentive to development on those lands?

State, Federal and fee (private mineral) leases have substantial differences. While State leases are generally limited to a maximum of 640 acres, Federal and fee leases often cover several thousand acres. A single producing well on Federal or fee minerals can often perpetuate a lease of thousands of acres. This makes these leases more valuable for development. Federal leases provide for a 12½% royalty, and private leases, particularly in non-producing areas are often the same. If State leases have the 16.67% royalty, and if geologic factors in the area are substantially the same, the State lands will be at a competitive disadvantage and can be the last lease drilled. The greatest potential revenue to the state, revenue from <u>producing</u> royalties, can be delayed or missed entirely.

The Report attempts to differentiate between production taxes and royalties. In substance, they both have the same effect and are costs on doing business. When costs are increased it results in an increase in the cost of the product. As Montana essentially competes with neighboring states for drilling dollars, an increased royalty rate can equate to those dollars going elsewhere.

The Report claims that "carrying costs" for 1/8th and 1/6th royalty leases are the same, only when production occurs will the lessee bear the additional royalty. This does not mean that the bonus for that bid would be the same. In a company's budgetary evaluation, the 12½% leases will have a higher bid value and should garner higher bonus dollars. This factor may lessen the amount paid for lease bonus amounts on State minerals. My personal experience is that we do business in

Montana and bid on State leases because of a favorable development climate and the existing lease royalty percentage.

The Report also infers that since overriding royalties are often assigned, an increase in the State royalty will have no detrimental affects on exploration and production because net revenue interests are already often reduced by these overrides. Certain companies and individuals assemble acreage positions, perform the expensive technical analysis and sell the prospective leases retaining an overriding royalty interest. These interests are retained by companies, investors, technical workers, and others in lieu of dollar compensation. Where the original lease royalty burden is greater, there is a smaller piece of the pie to distribute to the parties that contribute to the exploration process. Once again, the State lease with a $1/6^{th}$ royalty may end up with a lesser drilling desirability.

Raising taxes and fees does not always result in increased revenue to the governmental entity. Consider the ill advised 1990 Congressional tax increase on luxury boats. A ten percent tax was added to the cost of luxury yachts. Since a yacht costs anywhere from $100,000 and above, this means that at least $10,000 had to be paid to the government. According to a Congressional Joint Economic Committee Study, the boat industry nationwide lost 7,600 employees within one year. Congress originally estimated that the luxury tax on boats, aircraft, and jewelry would raise $5 million in taxes a year. Instead, the Treasury has lost $24 million through lost income-tax revenues and higher unemployment and welfare payments. An increase in the State royalty rate is not an automatic guarantee of increased revenues!

It will be easy to say that any objection from the petroleum industry, in a time of increased oil and gas prices, is simply self-serving. Much of this increased revenue is directed towards finding and producing new reserves. I would point out the State takes no risks but is benefiting from increased prices and production both from royalties and from taxes.

The Report, after a comparison to Wyoming and North Dakota royalty rates, recommends a royalty increase equal to or <u>higher</u> than that of those two states. Both states have situations where the royalty on state leases is less than $1/6^{th}$.

No evidence is presented in the Report, directly or indirectly indicating that the increased royalty rate in neighboring states had increased either states' total revenues from state leases. No evidence is presented, and therefore no conclusion can be drawn that an increase in the royalty rate in Montana would result in an increase in State Trust revenues. Until these matters are more completely addressed, can the board make a fully informed decision?

Will the state ultimately benefit more from inducements to drilling and production, or from increasing the royalty rates? Do lower royalty costs result in lower energy prices to the citizens of Montana? These matters are not addressed in the Report. While the Report offers an opinion as to what royalty rate represents "fair market value", the Report does not substantiate the conclusion that the royalty should be increased, or that such an increase would benefit the State.

Sincerely,

David Smith
President

Mason, Monte

From: Gary Polasek [GaryP@headington.com]
Sent: Monday, August 15, 2005 1:30 PM
To: Mason, Monte
Subject: Proposed Montana Royalty Rate Increase

Dear Mr. Mason,

I'm emailing you on behalf of Headington Oil, L.P. We are the leading driller and producer of Bakken formation wells in Montana. We have enjoyed our relationship with your state and in particular the outstanding people we have worked with on the Montana Board of Oil and Gas commission. Several things initially attracted us to your state in 1997 when we decided to make a major acquisition that set us up with significant operations in Montana. One of these was most certainly your royalty rates on state lands.

We are now very dismayed to hear you are considering reducing a major incentive that Headington has at least partially built into its economic considerations for wanting to conduct business in Montana. The existing royalty rate has surely caused us to lease and drill a signifcant amount of state acreage, some of which would surely not have been leased and developed under a higher royalty burden due to the unfavorable economics that would have resulted.

We implore you to hold the line on the current 1/8th royalty. If not for the independent oil producers who have been coaxed to your state by these lower rates and then have risked millions of dollars drilling wells, then for the American people who desperately need cheaper gasoline prices that can only be achieved by adding more oil production. This seems to be a most inopportune time to burden the oil industry with a **disincentive** to drill more wells.

Gary N. Polasek
Dallas Region Technical Manager
Headington Oil Company
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Mr. Monte Mason, Chief
Minerals management Bureau
P.O. Box 201601
Helena, MT 59620-1601

Subject: Royalty Rate Review

Dear Mr. Mason,

Thank you for the opportunity to comment on the proposed increase in royalty rate for State Land gas/oil production.

The review dated July 5, 2005 did a good job of explaining what a royalty is and how Montana State Lands compare with other states. I also read with interest the 20 comments received and the department response.

The majority of the comments disagree with the proposed increase. They site a potential turn down in interested parties to lease state lands. One operator, that has been doing oil well operating business in Montana since 1992, says directly that if the increase to royalty is enacted he will not drill on any state land. (page 27 of report update of August 3, 2005) This majority is primarily made up of gas/oil business people. The remaining comments are from, in general, current royalty recipients. Some are also oil and gas operators but they suggest the dual royalty similar to North Dakota or Wyoming.

This proposed increase in royalty rate on state land has already resulted in nominated tracts for bid in the September sale to be terminated. This chilling effect could result in less exploration and possible production on state lands and in fact, reduce overall income.

The review did not present a financial analysis that takes into account the loss of activity due to the royalty increase. I believe the comments to the review, and the removal of tracts to bid, suggest this should be done prior to enactment of an increase.

I recommend this proposed increase be postponed until a financial analysis is completed. Additional comments need to be solicited and the production tax component should be weighed in the decision. We need to be sure this increase will actually produce more income from State Land. Thank you,

Dan Lindseth
Box 1395
Choteau, Montana dandl@3rivers.net August 14, 2004

Northern Alliance of INDEPENDENT PRODUCERS

August 15, 2005

Monte Mason
Montana DNRC
P.O. Box 201601
Helena, MT 59620-1601

Re: Proposed royalty increase on School Trust Lands

Dear Mr. Mason:

On behalf of the Northern Alliance of Independent Producers, I would like to offer these comments and ask that the Board of Land Commissioners not increase royalty on oil and gas leases to $1/6^{th}$ as presented to the Board on July 18, 2005. Please share these comments with members of the Board.

The Northern Alliance is made up of oil and gas producers operating in Montana, North Dakota and South Dakota. Its members include some of the most aggressive companies exploring for oil and gas in this region, and who spend tens of millions of dollars each year in Montana, exploring and developing Montana's oil and gas resource. Our members have been some of the key players in eastern Montana in the last 2 years that have helped to triple the production in Richland County. One of the key reasons our members have done business in Montana is because of the stable tax climate that Montana has fostered since 1999. That climate has paid handsomely for Montana, and its citizens with new exploration, development and the jobs and tax revenues that go with it. We ask the Board to refrain from increasing royalty to $1/6^{th}$ for two primary reasons:

a.) First, raising royalties to $1/6^{th}$ will reduce Montana's competitive edge for retaining the investment capital that has been here during the past two years. Increased royalty expense is an additional cost that investors will consider, when deciding where to expend risk capital. Presumably, the goal in considering a change in policy is to increase state revenues. We submit that <u>increasing</u> state royalty will have the opposite affect, and will hurt exploration activities and state revenues. Stay the course that has been so successful for you and Montana thus far.

b.) Second, such a policy change does not serve our nation's broader energy security interest, and discourages increased domestic oil and gas production. If America is to become energy sufficient in the coming years, and reduce our dependency on foreign oil, we need to increase domestic oil and gas production, increase conservation and develop new energy systems and supplies. We should advance public policies that promote those ends. Increasing state royalty does not serve that long term effort. We believe that each state, the federal government, the public and the private sector have a roll in solving our nation's energy needs. Sound and stable tax and royalty policy at the state level will advance that goal.

We understand the appeal to change to a higher royalty rate, but we urge you to look beyond the short term attraction, and retain Montana's current royalty policy as the better long term policy choice. Your current royalty and tax structure has made Montana an attractive venue for oil and gas investment. Don't change that, in hopes of making more money. If the Board is determined to change to higher rate, then we would ask that you at least consider a mechanism like North Dakota's where the higher rate does not apply unless it is within a certain distance of production.

Sincerely,

Robert W. Harms

Robert W. Harms
President
Northern Alliance of Independent Producers
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